

Earthquake: A Practical Guide to Dealing With a Disaster

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On January 17, 1994, I received a phone call from a frantic client who explained that the top floor of his 35-unit apartment building was missing, a result of the 6.6 magnitude earthquake that had struck Northridge at 4:31 a.m.. Within hours, the building inspector had "red-tagged" his building; within days, adjoining property owners asserted claims for lost rent because their tenants were ordered to vacate as a result of the damage to my client's building. Soon tenants sought access to the building to retrieve their belongings. The client wanted our help in sorting out the array of problems facing him.

Following an earthquake, or any sort of natural disaster, a client who owns commercial real property may call on his lawyers to help deal with what is likely to be a complicated situation. This article will discuss some of the issues that may surface and will serve as a guide for responding to the immediate needs of a client with damaged income-producing real property.

IS THERE INSURANCE COVERAGE?

The owner's property insurance policies should be reviewed to determine the availability of earthquake coverage. Although it was available, my client did not have earthquake insurance because he found it to be prohibitively expensive. My client's experience is

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typical. The California Department of Insurance estimates that at least 80 percent of the apartment buildings damaged in the Northridge area were not covered by an earthquake policy.

Although Ins C §10081 requires that all policies of residential property insurance offer coverage for earthquake losses, there is no such requirement for commercial properties. The current proposal to create a state earthquake insurance fund focuses solely on homeowner's policies and will, in fact, tie in to the mandatory-offer rule of Ins C §10081. There is currently no proposal to encourage insurers to offer commercial earthquake policies, and it is unlikely that a client will have one.

When advising a client on whether to purchase earthquake coverage, consider whether the property is likely to qualify for earthquake coverage and whether the rent from the property could support additional debt used to remedy earthquake damage. If additional debt, even at a low interest rate, would be impossible to service, earthquake insurance is a necessity. On the other hand, if the building or the owner's personal resources could support debt financing of reconstruction costs, insurance coverage is less important.

A FEDERAL EMERGENCY MANAGEMENT AGENCY OFFICE WILL BE ESTABLISHED IN THE AREA

The Federal Emergency Management Agency (FEMA) is the federal agency charged with coordinating the overall disaster effort and providing disas-

ter assistance to individuals and families. Tenants should be referred to FEMA for temporary housing, grants of one to two months' advance rent payments, relocation assistance, and grants for personal property damage. FEMA may in some instances provide assistance to the owner of an apartment building who is unable to pay the mortgage secured by his personal residence because of the loss of rental income caused by the earthquake.

DEALING WITH LENDERS

Small Business Administration Offices

The Small Business Administration (SBA) is the direct provider of disaster assistance loans. Its disaster unit consists of a core permanent staff of 300 (called the "cadre") in four area offices. Following a disaster, the SBA brings attorneys, loan officers, verifiers, and other employees to the site of the crisis. In Northridge, the SBA brought in nearly 3000 employees and was easily California's largest lender for a time, evaluating nearly a quarter of a million loans applications from 15 loan centers, and ultimately approving 123,065 loans, representing \$4,033,288,000. In one day, the SBA's Northridge operation disbursed as much as \$22 million.

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Working With the Small Business Administration

The first advice, after determining whether there is insurance coverage, should be to find the nearest SBA office and begin the process of applying for a disaster loan. The SBA is authorized to make loans of up to \$1.5 million to restore property to its pre-disaster condition. 15 USC §636(b); 13 CFR Part 123. The lending rules for the disaster loan program have been substantially clarified and reorganized recently. 61 Fed Reg 22496 (Jan 31, 1996).

The day of the Northridge quake, I advised my client to go to the SBA office that had been set up to deal with the nearby Malibu fire a few months earlier. My client crossed out the words "MALIBU FIRE DISASTER LOAN APPLICATION" and wrote in "NORTHRIDGE DISASTER LOAN APPLICATION" on the application. It was one of the first of many thousands of applications submitted. When construction on my client's building was well under-

way, nearby property owners were still waiting for loan approval.

Applying for the SBA Loan

Any owner of damaged real property located in a "declared disaster area" is eligible to apply for a disaster loan. An area is considered a declared disaster area only if (1) the President of the United States declares the area a "major disaster" and authorizes federal assistance; (2) the SBA makes a physical disaster declaration; (3) the SBA makes a disaster declaration in response to a determination of natural disaster by the Secretary of Agriculture; or (4) the SBA makes a declaration in reliance on a state certification signed by the governor. See 13 CFR §123.3. President Clinton declared the Northridge area a major disaster area.

"Applications are processed as they are submitted . . . , [so] submit the application as expeditiously as possible."

The owner uses the Disaster Business Loan Application (see Form A in the appendix following this article) to seek disaster funds. The SBA reviews the application to determine whether the debt can be repaid from personal or business cash flow. 13 CFR §123.6. The size of the owner's operation (*i.e.*, total rents, number of employees) is not taken into account when determining eligibility for the loan.

The application requires information about the property, the owner of the property, and if the owner is an entity, the identity and social security numbers of all general partners, limited partners, or shareholders who own at least 20-percent interests. The application must include tax returns and financial statements of all owners. Further, SBA Form 739A (see Form B in the appendix) must be used to estimate the damage.

Loan applications are processed in the order received. When the application is complete, the SBA sends a loss verifier to inspect the property to determine the extent of the damage and the reasonableness of the loan request. The loss verifier will assist the owner in completing SBA Form 739A. In my client's case, the loss verifier met with my client and *completed* his estimate on January 18, 1996, the day after the earthquake.

The loan application must next be approved. Applications are processed as they are submitted. As a result, there is a tremendous incentive to submit the application as expeditiously as possible. Because our

application was one of the first submitted, it was approved within days. As more applications were submitted, the wait for approval became much longer.

Loan Terms

The interest rate charged on an SBA disaster loan is determined by the owner's ability or inability to obtain credit elsewhere. If the SBA determines that the borrower is unable to obtain credit elsewhere (considering the cash flow of the property, its value, and the resources of the borrower), the interest rate will not exceed 4-percent per year. Most loans will probably fit into this category, because it is unlikely that any commercial lender would make a loan secured by significantly damaged property. The maximum maturity for physical disaster loans is 30 years. 13 CFR §123.203.

If the SBA determines that the owner has the ability to obtain credit elsewhere, the interest rate can be set at the market rate in effect at the time of the disaster, or 8 percent, whichever is lower. The maximum term for this type of loan may not exceed three years.

SBA loans are generally secured by a deed of trust on the damaged property. However, the SBA may make an unsecured loan if there is no collateral and there is a reasonable assurance of repayment from some other source. In addition, it is also the SBA's policy to require any 20-percent owner to personally guarantee the loan. Even less than 20-percent owners will be asked for personal guaranties if their credit requires it. This policy is only rarely waived.

Normally, the first payment will be due five months from the date of the promissory note, and should be made to the SBA office in Denver, Colorado. The SBA may allow a longer lead time under special circumstances, such as seasonal or fluctuating income or a tremendous amount of necessary reconstruction. The estimated amount of time required to complete reconstruction of my client's building was one year. Without the 12-month lead time, my client would not have had the financial ability to undertake the project.

The Transaction

The loan documents are similar to those used in any commercial lending transaction. Typically, they will include:

- Loan agreement;
- Personal guaranty;
- Secured promissory note;
- Deed of Trust;
- Affidavit of ownership if property is held by a trust or entity; and

- Certification of hazard insurance naming the SBA as an additional insured.

All loan closing documents must be returned to the SBA within 60 days of loan approval. The borrower can return the closing documents either by mail or in person at an SBA loan closing center. The letter that transmits the closing documents should also request a disbursement of an initial sum (*e.g.*, \$10,000) for emergency measures, including hauling away debris, shoring up the building, and closing off plumbing, gas, sewerage, and electrical lines. Further, the closing documents require the owner to advise the SBA of the status of the repairs.

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It may be easier to conduct the closing by mail, because then the borrower, rather than an escrow officer or the lender, takes responsibility for many steps of the closing. The borrower first arranges for a title insurance company to write a title insurance policy. Many title insurers will offer discounted premiums for federal disaster victims. Next, the debtor executes and *records* the deed of trust. The debtor then provides the title insurer with the premium and a conformed copy of the recorded deed of trust. The title insurer will then send a preliminary title report to the SBA. To expedite disbursement of the loan proceeds, the attorney should arrange for the preliminary title report to be sent to the SBA by overnight courier.

The initial disbursement should arrive within 10-17 days after the loan is approved. The SBA will acknowledge receipt of the loan closing documents and request additional items for subsequent loan disbursements. The balance of the loan funds must be disbursed by the deadline contained in the loan agreement, which is usually six months. Generally, the SBA requires the following to disburse the balance of the loan proceeds:

- a preliminary work plan that indicates how the funds will be used, including plans, permits, and contracts;
- the title insurance policy; and
- a copy of the property insurance endorsement, naming the SBA as an additional insured.

Like construction loans, future disbursements are made in installments. The owner advances funds to the contractor and then requests a disbursement using an SBA form called a Borrower's Progress Certification. The SBA requires that all construction records must be retained for three years from the date of the final disbursement.

Receipt of a disbursement can take up to six weeks; therefore, the owner must be prepared to wait nearly two months between the time he or she advances the funds and receipt of loan proceeds. Usually, the owner will require a second source of financing to pay contractors, maintain the pace of construction, and avoid the filing of mechanic's liens. An owner may need to use equity lines, personal loans, and even credit cards for this purpose.

A building owner without the resources to advance significant parts of the construction budget will likely face frequent job interruptions and should anticipate mechanic's liens. In my client's case, this was an *enormous* problem. Generally, new funds were not disbursed until previously disbursed funds were completely exhausted. A line of credit secured by my client's home and an extremely understanding contractor deserve credit for my client's interruption-free construction schedule.

An owner may make a written request for an increase in the loan amount if loan funds are inadequate to complete the repairs. The request should include a detailed breakdown of the additional costs and the areas of the allocation in the loan agreement that were deficient.

Use of Loan Funds

Disaster loans are made specifically for the purpose of restoring property to its pre-disaster condition. The loan agreement will designate specific categories for which the loan proceeds can be used. For example, the loan agreement may allocate a specific amount of funds for, *e.g.*, the foundation, roof, and the carpeting. Deviations from the set amounts will result in default unless the loan agreement is modified. The allocation is based on the verifier's determination on SBA Form 739A, but these figures may turn out to be unrealistic once construction begins. The SBA was extremely flexible about reallocating from one category to another. For example, the foundation required very little repair, while the plumbing was far more costly than originally anticipated. We advised the SBA in writing of these types of complications as they arose and they were all resolved satisfactorily.

The amount of the loan may be increased by as much as 20 percent to protect from or mitigate dam-

age from future disasters of the same type. An earthquake may create an opportunity to obtain financing for the obligations to retrofit imposed by many California cities. Although SBA funds normally cannot be used to upgrade a property, SBA loans can be used to bring the property into compliance with city or county building codes that require this sort of upgrading. 13 CFR §123.7.

The loan amount may also be increased to cover the costs of stabilizing the property or removing debris, and these costs should not be overlooked in making the SBA loan application. The loan amount may also include accountant and attorney fees. Under some circumstances, the SBA loan may also cover the refinancing of an existing mortgage.

SBA loans will cover only uninsured physical damage. Insurance proceeds must be exhausted before loan funds are disbursed. If the insurance proceeds must be applied to an outstanding mortgage, the amount of the SBA loan should reflect this. 13 CFR §123.10.

"The loan amount may also include accountant and attorney fees."

The penalty for using disaster funds in a manner inconsistent with the loan agreement, or failure to return funds that are disbursed but not needed for repairs, is immediate repayment of 1½ times the original amount of the loan. 13 CFR §123.9. The SBA may conduct site inspections to verify the use of the disaster funds. The SBA also may audit the owner's books and records after the construction.

Working With Commercial Lenders

In all likelihood, the damaged property will already be encumbered. Most commercial lenders will evaluate the damage to their security, and it is important to communicate to the lender that the owner is diligently taking all steps necessary to restore the value of the security.

Following the Northridge earthquake, many lenders offered their borrowers payment moratoriums. Six-month "loan freezes" were typically offered during which payments of principal and interest were postponed. My client obtained only a six-month moratorium despite the enormous amount of damage and an anticipated one-year construction schedule. The length of the moratorium bore no relationship to the amount of damage. Fortunately, my client's small loan balance lessened the impact of this problem. In other situations, obtaining a more lengthy moratorium

could be critical. However, it is unlikely that significantly longer moratoriums will be granted. Lenders seem to make these arrangements ostensibly as a sign of goodwill, but also out of concern for avoiding the public relations disaster that would be caused by foreclosing in the midst of a disaster.

A lender typically will be named as an additional insured on any property insurance policies. As a result, the proceeds of such policies will be made payable to both the property owner and the lender, requiring the endorsement of each. Communication between these parties from the outset will be particularly helpful if the lender must later be approached to endorse an insurance draft. However, the lender may not refuse to make the endorsement if it did not require earthquake insurance. In *Ziello v Superior Court* (1995) 36 CA4th 321, 42 CR2d 251, the court found that when a lender did not require the borrower to obtain earthquake insurance on the property securing the loan, it had no right to receive or control the insurance proceeds paid as a result of earthquake damage to the property.

LIABILITY ISSUES

Nuisance

All cities have procedures for dealing with issues of public safety following an earthquake or other disaster. See Health & S C §17980.1-17980.5; San Diego Municipal Code §§51.0101-51.0111; Santa Monica Municipal Code §§8.12.010-8.12.130.

Anything injurious to health, or the unlawful obstruction of a street or park, is a nuisance per se. CC §3479. Damaged property will be treated as a public nuisance in an action brought by a city. The attorney should advise the property owner to expect an inspection by a city engineer, and, depending on the extent of the damage, a notice from the city attorney's office to either abate the nuisance or demolish the structure. After sending such notices, cities hold hearings to determine what action is necessary, and generally streamline their permit processes for the emergency. A former Los Angeles city attorney explained that one goal achieved through this process is to learn which owners will responsibly deal with their properties and which owners are likely to be more problematic for the city later.

If the property owner retains a seismic engineer to work with the city, approval of construction plans can usually be obtained on an expedited basis. A seismic engineer is a certified structural engineer who specializes in earthquake issues. Unless the property owner establishes a relationship with a seismic engineer well in advance of an earthquake, the owner will face the

impossible task of locating and retaining a seismic engineer when they are in the greatest demand.

In my client's case, we agreed to have our seismic engineer submit a plan by the morning following our nuisance hearing. Plan approval was obtained only hours after we submitted our plans and permit fees were waived. That was achieved, in part, by demonstrating to the city that we were part of the solution to their public safety and housing shortage concerns. Most cities, at a minimum, will require a written report and plan of a certified structural engineer for shoring up and stabilizing the structure.

Although a city may act quickly to abate a nuisance that threatens public safety, it must later be prepared to establish that an emergency actually existed. As a practical matter, cities hold hearings and take testimony from building owners and their experts before deciding to demolish a structure. In *Rose v City of Coalinga* (1987) 190 CA3d 1627, 1635, 236 CR 124, the city of Coalinga demolished most of its entire downtown area following the 1983 earthquake. The court ruled in favor of a property owner in an inverse condemnation action when the city attorney insisted on releases from the building owners and gave the owner only two hours' notice before the demolition. The authors of the State Office of Emergency Services structural safety report later testified that they concluded six weeks before the demolition that the building was repairable and should not have been demolished.

The *Rose* case illustrates the importance of insisting on a fair evaluation of the hazard despite the accelerated pace of the emergency hearings, as well as the benefit of retaining a credible seismic engineer to assist in the process. But see *Customer Co. v City of Sacramento* (1995) 10 C4th 368, 41 CR2d 658, which limited the scope of inverse condemnation for property damage caused by the actions of public employees.

If the damage is extensive, the city may order adjacent buildings, or portions of them, vacated. Within days of the Northridge earthquake, property owners on either side of my client's building were asserting claims that my client was liable for their lost rental income because of his alleged inaction.

The front façade of my client's building was so severely damaged that it was featured in national and local media stories about the earthquake. Although massive amounts of rubble fell, it fell solely on my client's property. The sides and rear of the building were remarkably intact. Nevertheless, the city "red-tagged" portions of adjacent buildings out of a concern that my client's building would fall to one side. Without identifying legal theories, presumably because of the lack of any relevant cases involving

earthquakes, the adjoining landowners retained lawyers who sent us letters asserting my client's responsibility for their lost rental income.

The most sound legal action on which the adjoining owners could have asserted claims was for a private nuisance. One commentator has expressed the opinion that the owner of the offending land who fails to remedy an earthquake-caused condition can be liable for nuisance. See *Landslide and Subsidence Liability* §7.7 (Cal CEB 1974), citing *People v Green* (1968) 264 CA2d 774, 70 CR 818. In *Lussier v San Lorenzo Valley Water Dist.* (1988) 206 CA3d 92, 253 CR 470, the owner of land failed to remove fallen trees and debris caused by a storm. The court found that a landowner has a duty to take steps to abate a natural condition that invades another's use and enjoyment of his property. As a result, a property owner's obligation appears to be to promptly repair the damaged property so as not to interfere with the use and enjoyment (and rental income) of adjacent landowners.

In fact, my client had acted expeditiously within the first few days of the earthquake, to erect a fence around the property, obtain financing, retain a contractor, and obtain plan approval from the city. However, his efforts were not apparent to the adjoining landowners, and their concern was understandable. When we communicated with the adjoining landowners and advised them of our progress, they calmed down. We also eliminated the issue by convincing the city to remove the "red tags" on the adjacent property by offering our seismic engineer's testimony that our building posed no risk to the adjacent ones.

Attorneys should advise clients to keep adjoining landowners notified of the progress that is made in the first few days following a disaster. If it is available, providing the adjoining landowners with copies of the seismic engineer's report may be helpful.

Negligence

If an owner fails to perform earthquake retrofitting, can a person injured as a result of earthquake damage to the property claim the owner is liable under a negligence theory? We can only speculate, because there are no reported decisions that address an earthquake-damaged property owner's liability for negligence. An act of God, such as an earthquake, is a superseding cause for which negligence liability will not arise. See Restatement (Second) of Torts §§450, 451. However, if an earthquake only exacerbates the owner's negligent failure to retrofit, liability could arise. For example, a sudden and unexpected wind that causes a fire to spread to adjoining land could be a superseding cause, but damages would be foreseeable when

maintaining a rubbish dump fire during high winds. See 6 Witkin, *Summary of California Law, Torts* §977 (9th ed 1988), comparing *McVay v Central Cal. Inv. Co.* (1907) 6 CA 184, 91 P 745 with *Rocca v Tuolumne County Elec. Power & Light Co.* (1926) 76 CA 569, 245 P 468.

The issue is whether the property owner should foresee earthquake damage to a building that does not comply with mandatory earthquake retrofitting requirements. Particularly in an area known to be on or around a fault line, the owner of such properties should be concerned. In fact, under the negligence per se doctrine, the failure of the owner to exercise due care could be presumed for violating an ordinance that requires retrofitting. See Evid C §669.

Property should be searched carefully as soon as possible for injured persons. In *Stevenson v San Francisco Housing Auth.* (1994) 24 CA4th 269, 29 CR2d 398, plaintiff sued the owners of the building where her father lived, alleging that structural defects in the building, existing at the time of the 1989 Loma Prieta earthquake, caused the building to shake so violently that a flying object struck plaintiff's father and caused serious head injuries. He was found by the building manager seven days after the earthquake, severely dehydrated, and died several months later allegedly as a result of the injuries.

Although the case addressed the impact of governmental immunity on the action against the San Francisco Housing Authority, it also noted that the owners were sued for breach of the implied warranty of habitability, negligence, and other causes of action. Plaintiff's theory was that liability arose, in part, from the failure to promptly locate the injured person. The case does not indicate whether the owner was in fact prevented from going inside the building. However, access to significantly damaged structures is generally limited following an earthquake, and it is conceivable that the owner may have been prevented from searching the property. Regardless, steps should be taken to ensure that the client's property is not only stabilized, but also adequately searched.

DEALING WITH TENANTS

Lease Termination

A lease terminates when the property is completely or partially destroyed if, at the time the lease was entered into, the landlord had reason to believe that the part destroyed was a "material inducement" to the tenant to enter into the lease, as it obviously would be with an apartment. CC §§1933(4), 1932(2). The tenant's obligation to pay rent is also terminated if the building is destroyed. The landlord is subject to fines

and penalties for demanding or collecting rent from a tenant whose apartment is untenable. See CC §§1941.1, 1942.4. See California Eviction Defense Manual, chap 15 (2d ed Cal CEB 1993) on warranties of habitability.

In *Aguirre v Lee* (1993) 20 CA4th 1646, 25 CR2d 367, the court found that a landlord's decision to repair a building rather than destroy it provided sufficient evidence from which the jury could conclude that the earthquake had not destroyed the building. Because the building was not destroyed, the tenancy was not terminated. Of course, the landlord would have been subject to fines for seeking rent for an untenable apartment.

Rent Control Issues

Some rent control ordinances include provisions regarding earthquake damage. For example, following the Northridge earthquake, Los Angeles and Santa Monica each enacted statutes prohibiting a landlord from evicting a tenant for failure to pay rent when an apartment is made untenable by earthquake damage. The ordinance requires landlords to offer the unit to the tenant after repairs are completed. Other disaster-related statutes may affect the circumstances under which the tenancy may be treated as terminated. See, e.g., City of Santa Monica Emergency Ordinance 1823, §14; City of Los Angeles Ordinances Nos. 1693361, 1693721, 169575.

Rent control ordinances may also affect reconstruction. Generally, rent control ordinances contain a mechanism for passing through the cost of reconstruction to the tenants in the form of higher rents. This process may be substantially streamlined by the city council following a disaster to encourage prompt restoration of property. For property owners whose rents are substantially below market because of rent control, this increase may be one of the unplanned benefits of earthquake damage. It may be advisable to have a rent control expert review the entire project from the outset. The availability of a pass-through may depend on how much money is spent, how it is spent, and the source of funds. For example, to address restoration costs attributed to the Northridge earthquake, Santa Monica adopted a special ordinance that allows a dollar-for-dollar rent increase for qualifying expenditures. See Santa Monica Rent Control Regulation §4113.

Allowing Tenants Access to Their Personal Property

My client's building was "red tagged" and vacated within hours of the earthquake, prohibiting tenants

from re-entering to remove their belongings unless accompanied by members of the fire department. The fire department escorted small groups of tenants through the building by appointment only. Because of the tremendous number of displaced residents in the area, this process was time-consuming and frustrating for the tenants.

Lost and Abandoned Personal Property

The landlord must return all personal property in his or her control if the tenant makes a written request, including a description of the property, within 18 days after vacating the premises. The tenant must pay all reasonable costs associated with the removal and storage of the property. CC §§1965(a)(3), 1965(b)(2). If all conditions of CC §1965 are otherwise satisfied, the tenant must remove the property at a time mutually agreed on by the landlord and tenant but not later than 72 hours after the tenant pays the costs of storage described above. See California Eviction Defense Manual, chap 28 (2d ed Cal CEB 1993) on lost and abandoned personal property.

Depending on the extent of the earthquake damage and the number of affected units, it is likely that some tenants will leave behind at least some of their belongings. To avoid the risk of conversion claims, the landlord must classify the property as reasonably believed to have been abandoned or lost and follow the procedures set out in CC §1980. Personal property remaining on the premises after they have been vacated must be disposed of pursuant to CC §§1980-1991. The landlord must give the tenant written notice of the right to reclaim. Civil Code §1984 provides a statutory form of notice. If the landlord has not received a request for the property, the property may be treated as abandoned and the procedure set forth in CC §1980 may be followed instead of the procedure set forth in CC §1965.

If the owner of property remaining in the building cannot be determined, the landlord must dispose of the property pursuant to CC §§2080-2082. Lost property that is reasonably believed to be worth \$100 or more must be turned over to the appropriate law enforcement officials, along with the landlord's affidavit describing the property and stating where and when it was found. If the appropriate law enforcement officials refuse to accept the property, the landlord may dispose of the property as if it were abandoned. For property valued at \$250 or more, if it is not claimed by the owner within 90 days, law enforcement officials must publish a notice of the availability of the property. If it is not claimed within seven days following publication of a notice, the property will return to the landlord and title will vest

in the landlord. CC §2080.3. Alternatively, some cities have enacted ordinances that require lost property to be sold at auction for the benefit of the city.

Until the property is disposed of or returned to the tenant, it must either be left on the vacated premises or stored in a safe place. A landlord is not liable for any loss unless it is caused by his or her deliberate or negligent act. CC §1986. The landlord must release the property to the former tenant on payment of the reasonable cost of storage, as long as possession is taken no later than the deadline stated in the notice. CC §1987(a). If the property is not claimed as of the noticed deadline, it must still be released to a former tenant who claims possession before it is actually sold, provided the reasonable costs of storage and advertising are paid. CC §1987(b).

Any property that is not returned to the tenant before the deadline provided in the notice may be kept by the landlord for his or her own use or otherwise disposed of if the landlord reasonably believes that the total resale value of the property is less than \$300. Property worth more than \$300 must be sold at public sale by competitive bidding. CC §1988(a). The time and place of the public sale must be published once a week for two successive weeks, with at least five days intervening between each publication, in a newspaper of general circulation published in the county where the sale will be held. CC §1988(b), Govt C §6066. After deduction of the costs of storage, advertising, and sale, any balance of the proceeds of the sale that is not claimed by the former tenant must be paid to the treasury of the county in which the sale took place within 30 days after the date of sale. The former tenant may claim the proceeds from the county within one year, after which the proceeds become the property of the state. CC §1988(c).

Under the circumstances, my client decided to take an alternate course. Although some tenants removed their possessions, others had no place to take them, instead leaving them in their apartments. During the course of the construction, my client boxed any remaining items in individual, numbered crates and stored them in the basement at his expense. My client felt that the procedure for abandoned property was unduly burdensome because of the vast number of affected units. Although not ideal, removing and storing a tenant's personal property in their name is not conversion. *Jordan v Talbot* (1961) 55 C2d 597, 610, 12 CR 488. In such cases, a tenant is entitled to recover only actual damages in an amount sufficient to compensate the tenant for any impairment of the property or loss of its use. In fact, no tenant ever asserted a claim.

TAX ISSUES

Casualty Losses

The owner of property destroyed by a disaster, including an earthquake, is entitled to a casualty loss deduction to the extent that the loss is not covered by insurance. IRC §165, See IRS Pub 17 p 192 (1995); IRS Pub 547 IRS Pub 547, Nonbusiness Disasters, Casualties and Thefts (1995). *Paul Abrams*, TC Memo 1981-231. Generally, a casualty loss must be taken in the year the loss occurred. However, special treatment is afforded taxpayers who suffer losses in areas that are declared disasters by the President. IRC §165(i)(1). The deduction can be taken in the tax year in which the disaster occurs or in the tax year immediately preceding the tax year in which the disaster occurs. IRC §165(i)(1).

In the case of a partial loss of property, the difference in value immediately before and after the earthquake must be determined by a competent appraisal. Reg §1.165-7(b)(1). For example, if the building is valued at \$5 million before the earthquake and is appraised at \$3 million afterwards, there is potentially a \$2-million deductible casualty loss. However, the cost of expenditures to prevent future losses (*e.g.*, retrofitting) are not deductible as casualties. See Rev Rul 70-90, 1970-1 Cum Bull 37.

Any insurance proceeds up to this amount will offset this loss and will reduce the amount of the deduction. See Reg §1.165-1(c)(4). Any insurance in excess of the decrease in value is treated as a casualty gain. To the extent that the owner recovers insurance for lost rental income, the amount of the insurance is treated as ordinary income under IRC §61. See *Maryland Shipbuilding & Drydock Co. v U.S.* (Ct Cl 1969) 409 F2d 1363, 1365.

The IRS might take the position that the decline in value is less than the cost of repairs if the repairs enhance the pre-earthquake value of the building. See Reg §1.165-7(a)(2)(ii). Further, the repairs must actually be made before they can be used as a measure of the loss. See *Paul Abrams*, TC Memo 1981-231.

Under IRC §1033, if insurance proceeds exceed the owner's basis in the property, the casualty gain may be eligible for rollover to another property. A taxpayer elects nonrecognition for the year in which such gain is realized and then must purchase similar property within two years. However, all of the details of the conversion (including, *e.g.*, description of the property, date and type of conversion, computation of gain, and decision to replace) must be reported in a statement attached to the return.

Capital Improvements

The amount spent on capital improvements must be capitalized (*i.e.*, added to the taxpayer's basis in the property). IRC §1016(a)(1). Therefore, capital improvements financed by SBA loans will to some extent result in future depreciation deductions. For example, the costs of retrofitting the property must be capitalized as permanent improvements.

Property Taxes

Real property in California is taxed at the rate of 1 percent of the property's adjusted purchase price or its value on the lien date (*i.e.*, January 1) of the preceding fiscal year. Normally, the destruction of property after the lien date would have no effect on the liability for, or the amount of tax due for the assessed period. However, Rev & T C §170 provides relief by allowing a taxpayer to apply for a reassessment for the fiscal year in which a disaster occurs. The assessor then appraises the property and notifies the owner of the amount of the proposed reassessment. As a result, the property owner will be taxed only on the damaged value of the property for the year of the disaster.

In succeeding years, the property is taxed based on its fair market value as of the lien date. Normally, construction causes a reassessment of property. However, Rev & T C §70(c) exempts property from reassessment following reconstruction to remedy property destroyed by misfortune or calamity when, after reconstruction, the property is substantially equivalent to its former state.

Local Business Taxes

Many government entities will grant extensions for city and local tax payments on request. For example, many parties contacted the Budget and Audit Manager for the city of Beverly Hills to request an extension of the date on which the business license tax was due. The request was put on the City Council's agenda and an extension was ultimately granted. Local property tax collectors may also grant relief for disaster victims, so an attorney should make inquiries in the appropriate counties.

PREPARE FOR A DISASTER NOW

All owners of California real property face the risk of an earthquake and should take steps now to prepare for an earthquake. A recent study by Stanford University professor Hareh C. Shah and Menlo Park-based Risk Management Systems, Inc., estimates that if a 8.3 magnitude quake struck San Francisco, eco-

omic losses would range from \$175 billion to \$220 billion. Following are some steps that might be taken to assure as little disruption as possible.

SBA loan applications require certain current information; therefore, property owners should keep current at all times (1) three years' federal income tax returns, (2) copies of, *e.g.*, deeds, trust deeds, and leases, (3) a written description of the property, and (4) personal and business financial statements.

The expert advice of a seismic engineer would be extremely helpful to assess damage and address the safety concerns of local governments. Accordingly, it might be prudent to identify contractors and seismic engineers in advance who could be called on in the event of a disaster.

There can also be a long delay between applying for and obtaining SBA loan disbursements. If possible, property owners should have an available credit source to fund the ongoing outlays that will inevitably be required during the course of reconstruction.

Disaster Checklist

Financing

- Obtain and submit SBA loan application.
- Obtain financial statements and tax returns.
- Obtain secondary source of financing, if necessary
- Communicate with existing lenders.
- Make insurance claims.

Government Entities

- Retain seismic engineer.
- Prepare for and attend nuisance hearings.
- Obtain building permits.
- Retain rent control expert if applicable.

Avoid Disputes

- Communicate with adjoining landowners.
- Obtain access to, stabilize, and search the building.

Tenants

- Obtain access to building for removal of belongings.
- Return or treat personal property as lost or abandoned.
- Make referrals to Federal Emergency Management Agency (FEMA).

Taxation

- Apply for property tax reassessment.
- Involve accountant and/or retain tax expert if necessary.
- Arrange for appraisals.

Appendix

FORM A.
Disaster Business
Loan Application

SBA DISASTER BUSINESS LOAN APPLICATION						OMB No. 3245-0017
U.S. Small Business Administration		Physical Injury Filing Deadline		Economic Injury Filing Deadline		
		NOTE:				
<input type="checkbox"/> Physical Injury		<input type="checkbox"/> Economic Injury				
1. APPLICANT'S LEGAL NAME			2. TELEPHONE NUMBER (including area code)			
3. TRADE NAME (if different from legal name)			4. FEDERAL EMPLOYER'S TAX I.D. NUMBER (if applicable)			
5. MAILING ADDRESS						
number, street, and/or P.O. Box No.				City	state	zip
6. DAMAGED PROPERTY ADDRESS						
number, street, or rural route				City	county	state zip
7. BUSINESS LOCATED ON:		<input type="checkbox"/> Owned Property		<input type="checkbox"/> Leased Property		
8. DATE BUSINESS ESTABLISHED:						
9. ORGANIZATION TYPE:		<input type="checkbox"/> sole proprietorship		<input type="checkbox"/> partnership		
		<input type="checkbox"/> limited partnership		<input type="checkbox"/> corporation		
		<input type="checkbox"/> nonprofit organization				
10. AMOUNT OF LOAN REQUEST <small>If unknown enter a question mark</small>		PHYSICAL DAMAGE	ECONOMIC INJURY	11. UNDER CURRENT MGMT. SINCE		
12. MANAGEMENT Complete for each proprietor, each limited partner who owns 20% or more interest and each general partner, or each stockholder owning 20% or more voting stock.						
Name	Title/Office	% Owned	Social Security No.	(Area Code) Telephone Number	Race*	Sex*
Name	Title/Office	% Owned	Social Security No.	(Area Code) Telephone Number	Race*	Sex*
Name	Title/Office	% Owned	Social Security No.	(Area Code) Telephone Number	Race*	Sex*
Name	Title/Office	% Owned	Social Security No.	(Area Code) Telephone Number	Race*	Sex*
Name	Title/Office	% Owned	Social Security No.	(Area Code) Telephone Number	Race*	Sex*
* This data is collected for statistical purposes only. It has no bearing on the decision to approve or decline this loan application.						
13. Are any of the above individuals (a) presently under indictment, on parole or probation, or have they ever been (b) charged with or arrested for any criminal offense other than a minor motor vehicle violation, or (c) convicted, placed on pretrial diversion, or placed on any form of probation including adjudication withheld pending probation for any criminal offense other than a minor motor vehicle violation?						
<input type="checkbox"/> YES <input type="checkbox"/> NO						
14. I have not paid a representative (attorney, accountant, etc.) to assist me with this application except:						
name and address of representative (please print)				fee charged or agreed upon		
If anyone completes this application on your behalf, whether there is any charge or not, that person must sign in this space below.						
signature of representative				date signed		
Parts 103, 104, and 122 of Title 13 of the Code of Federal Regulations contain provisions covering appearances and compensation of persons representing SBA applicants. Section 103.13-5 authorizes the suspension or revocation of the privilege of any such person to appear before SBA for charging a fee deemed unreasonable by SBA for the services actually performed, charging of unreasonable expenses, or violation of any applicable regulation. In addition, whoever commits any fraud, by false or misleading statement of representation, or by conspiracy, shall be subject to the penalty of any Federal or state statute.						
If your application is approved, you may be eligible for additional funds to cover the cost of mitigating measures. It is not necessary for the description and cost estimates to be submitted with the application. SBA approval of the mitigating measures will be required before any loan increase. If you are interested in having SBA consider this increase, please check this box. <input type="checkbox"/>						
IF YOUR LOAN IS APPROVED, ADDITIONAL INFORMATION WILL BE REQUIRED PRIOR TO LOAN CLOSING. YOU WILL BE ADVISED IN WRITING WHAT DOCUMENTS WILL BE NEEDED TO OBTAIN YOUR FUNDS.						



OTHER INFORMATION		
15. The applicant or its owners have never been involved in bankruptcy or insolvency proceedings except:	Provide dates and details	
16. The applicant or its owners have no outstanding judgements, tax liens, or pending lawsuits against them except:	Provide dates and details	
17. No owner, owner's spouse or household member work for SBA, Small Business Advisory Council, SCORE, ACE, or any other Federal Agency except:	Provide names and organizations	
18. Within the past 1 year, no owner with 20% or more interest or general partner has been convicted of a criminal offense committed during and in connection with a riot or civil disorder except:	Provide dates and details	
19. The Applicant or its owners have never had any Federal loans except:	Provide dates and details	
FILING REQUIREMENTS (please submit)		
20. Copies of the 3 most recent, complete Federal Income Tax Returns including all schedules. If these are not readily available, complete and sign the attached IRS Form 8821 to meet this requirement. If this is a new business that has not filed 3 Federal Tax Returns, submit the ones you have. SBA will contact you if any additional information is needed (i.e., forecasts, etc.).		
21. A current (dated within 90 days of application) business balance sheet (SBA Form 413 may be used for sole proprietorships), a current profit and loss statement, and a current schedule of liabilities. (Sample format for schedule of liabilities attached for your convenience).		
22. For each owner having a 20% or more interest and each general partner, a current (dated within 90 days of application) personal financial statement (SBA Form 413 may be used for this purpose) and a complete copy, including all schedules, of the most recent Federal Income Tax Return. If tax returns are not readily available, complete and sign the attached IRS Form 8821 to meet this requirement.		
23. A complete copy, including all schedules, of the latest Federal Income Tax Return for any affiliate. Affiliates include business parents, subsidiaries or other businesses with common ownership or management. If these tax returns are not available, have an authorized individual complete and sign the attached IRS Form 8821 to meet this requirement.		
24. If your application includes physical injury, complete and sign the attached SBA Form 739A, "Verification of Business Disaster Loss."		
25. If your insurance covers this loss (regardless of the current status of your claim), please provide the name and telephone number of your agent and/or claims adjuster.		
26. If your application includes economic injury please submit the attached SBA Form 1368, "Additional Filing Requirements - Economic Injury Disaster Loan (EIDL)."		
AUTHORIZATIONS		
Unless I check this box, I authorize my insurance company to release to SBA all records and information pertaining to losses caused by this disaster .		
<input type="checkbox"/> NO		
Unless I check this box, you have my permission, to release information to other local, private, or State disaster relief services.		
<input type="checkbox"/> NO		
AGREEMENTS AND CERTIFICATIONS		
APPLICANT CERTIFIES AND AGREES THAT:		
Applicant agrees that SBA may release information contained in this application to other Federal agencies for disaster related purposes.		
No Person shall, on grounds of age, color, handicap, marital status, national origin, race, religion or sex, be excluded from participation in, be denied the benefits of, or otherwise be subjected to discrimination under any program or activity for which applicant receives Federal financial assistance from SBA.		
Applicant will report to the SBA Office of the Inspector General, Washington, D.C. 20416, any Federal employee who offers, in return for compensation of any kind, to help get this loan approved. Applicant has not paid anyone connected with the Federal government for help in getting this loan.		
All information in this application is true and complete to the best of my knowledge. All financial statements submitted with the application fully and accurately present the financial position of the business. No disclosures have been omitted in these financial statements. This certification also applies to any financial statements submitted subsequent to this date. Applicant understands that false statements may result in the forfeiture of benefits and possible prosecution by the U.S. Attorney General (reference 18 U.S.C. 1001 and/or 15 U.S.C. 645).		
SIGNATURE	TITLE	DATE

NOTE: PLEASE READ, DETACH AND RETAIN FOR YOUR RECORDS**STATEMENTS REQUIRED BY LAWS AND EXECUTIVE ORDERS**

Federal executive agencies, including the Small Business Administration (SBA), are required to withhold or limit financial assistance and to provide special notices to applicants in order to comply with legislation passed by the Congress and Executive Orders issued by the President. SBA has issued regulations implementing these laws and executive orders and they are contained in Parts 112, 113 and 116, Title 13, Code of Federal Regulations (CFR), Chapter 1, or Standard Operating Procedures (SOP's). This form contains a brief summary of the various laws and executive orders that affect SBA's disaster loan program and gives applicants the notices required by law or otherwise.

**Right to Financial Privacy Act of 1978
(12 U.S.C. 3401)**

This is notice to you, as required by the Right to Financial Privacy act of 1978, of SBA's access rights to financial records held by financial institutions that are or have been doing business with you or your business, including a financial institution participating in a loan or loan guaranty. The law provides that SBA shall have a right of access to your financial records in connection with its consideration or administration of assistance to you in the form of a Government loan or loan guaranty agreement. SBA is required to provide a certificate of its compliance with the Act to a financial institution in connection with its first request for access to your financial records, after which no further certification is required for subsequent access. The law also provides that SBA's access rights continue for the term of any approved loan or loan guaranty. No further notice to you of SBA's access rights is required during the term of such agreement. The law also authorizes SBA to transfer to another Government authority any financial records included in an application for a loan, or concerning an approved loan or loan guaranty, as necessary to process, service or foreclose a loan or loan guaranty or to collect on a defaulted loan or loan guaranty. No further transfer of your financial records to another Government authority will be permitted by SBA except as required by or permitted by law.

**Freedom of Information Act
(5 U.S.C. 552a)**

This law provides, with some exceptions, that SBA must supply information reflected in Agency files and records to a person requesting it. Information about approved loans that will be automatically released includes, among other things, statistics on our loan programs (individual borrowers are not identified in the statistics) and other information such as the names of the borrowers (and their officers, directors, stockholders or partners), the collateral pledged to secure the loan, the amount of the loan, its purpose in general terms and the maturity. Proprietary data on a borrower would not routinely be made available to third parties. All requests under this Act are to be addressed to the appropriate SBA office and be identified as a Freedom of Information request. Any person concerned with requesting information under the Freedom of Information Act may contact the Director, Freedom of Information/Privacy Acts Division, Small Business Administration, Washington, DC 20416, for more information about the Agency's procedures.

**Occupational Safety and Health Act
(15 U.S.C. 651 et seq.)**

This legislation authorizes the Occupational Safety and Health Administration in the Department of Labor to require businesses to modify facilities and procedures to protect employees or pay penalty fees. In some instances the business can be forced to cease operations or be prevented from starting operations in a new facility. Therefore, in some instances, SBA may require additional information from an applicant to determine whether the business will be in compliance with OSHA regulations and allowed to operate its facility after the loan is approved or disbursed. All borrowers must certify to SBA that OSHA requirements that apply to the borrower's business have been determined and that the borrower is, to the best of its knowledge, in compliance.

Debt Collection Act of 1982 and Deficit Reduction Act of 1984
(31 U.S.C. 3701 et seq. and other titles)

These laws require SBA to aggressively collect any loan payments which become delinquent. SBA must obtain your taxpayer identification number when you apply for a loan. If you receive a loan and do not make payments when they become due, SBA may take one or more of the following actions:

- * Report the delinquency to credit bureaus
- * Offset your income tax refunds or other amounts due you from the Federal Government
- * Refer the account to a private collection agency
- * Suspend or disbar the firm from doing business with the Federal Government
- * Refer your loan to the Department of Justice
- * Foreclose on collateral or take other actions permitted in the loan instruments

Policy Concerning Representatives and Their Fees

An applicant for a loan from SBA may obtain the assistance of any attorney, accountant, engineer, appraiser or other representative to aid in the preparation and presentation of the application to SBA; however, such representation is not mandatory. In the event a loan is approved, the services of an attorney may be necessary to assist in the preparation of closing documents, title abstracts, etc. SBA will allow the payment of reasonable fees or other compensation for services performed by such representatives on behalf of the applicant.

There are no "authorized representatives" of SBA, other than our regular salaried employees. Payment of any fee or gratuity to SBA employees is illegal and will subject the parties to such a transaction to prosecution.

SBA Regulations (Part 103, Sec. 103.13-5(c)) prohibit representatives from charging or proposing to charge any contingent fee for services performed in connection with an SBA loan unless the amount of such fee bears a necessary and reasonable relationship to the services actually performed; or to charge for any expenses which are not deemed by SBA to have been necessary in connection with the application. The Regulations (Part 120, Sec.120.104-2) also prohibit the payment of any bonus, brokerage fee or commission in connection with SBA loans.

In line with these Regulations, SBA will not approve placement or finder's fees for the use or attempted use of influence in obtaining or trying to obtain an SBA loan, or fees based solely upon a percentage of the approved loan or any part thereof.

Fees which will be approved will be limited to reasonable sums of services actually rendered in connection with the application or the closing, based upon the time and effort required, the qualifications of the representative and the nature and extent of the services rendered by such representatives. Representatives of the loan applicants will be required to execute an agreement as to their compensation for services rendered in connection with said loan.

It is the responsibility of the applicant to set forth in the appropriate section of the application the names of all persons engaged by or on behalf of the applicant. Applicants are required to advise the SBA disaster office in writing the names and fees of any representative engaged by the applicant subsequent to the filing of the application. This reporting requirement is approved under OMB Approval Number 2345-0016.

Any loan applicant having any question concerning the payments of fees, or the reasonableness of fees, should communicate with the Field Office where the application is filed.

FORM B.
SBA Form 739A



SMALL BUSINESS ADMINISTRATION
VERIFICATION OF BUSINESS DISASTER LOSS

OMB No. 3245-0017

PART I TO BE COMPLETED BY APPLICANT						
A. Firm Name:	B. Home Phone No.	C. Show names of intersecting streets nearest damaged property <div style="text-align: center; margin: 10px 0;"> </div>				
D. Type of Business:	E. Business Phone No.					
F. Lessee or Owner:						
G. Person in Contact:						
H. Addresses of business where loss occurred:						
I. Machinery, Equipment, Inventory (use additional sheets if necessary)						
Item	Quantity	Description of Item	Applicant		For SBA use only	
			Repair	Replacement Cost	Loss Verifier	O.S.
1						
2						
3						
4						
5						
6						
7						
8						
9						
10						
11						
12						
13						
14						
15						
16						
17						
18						
19						
20						
21						
22						
		% of salvageable value of any above items; if applicable, subtract from request amount.				
APPLICANT'S TOTAL						
LOSS VERIFIER'S TOTAL						
J. Was applicant present during verification? <input type="checkbox"/> yes <input type="checkbox"/> no					Date	
Applicant's Signature:				Date		See Comments On Reverse Side

